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Federal Communications Commission
Office of Secretary

UNITED STATES
TELEPHONE
ASSOCIATION

October 3, 1996

DOCKET FILE COPY ORIGINAL

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, D.C. 20554

RE: Ex Parte Filing
CC Docket No. 96-45

Dear Mr. Caton:

The United States Telephone Association (USTA) sent the attached letter to the Federal-State Joint Board on October 3, 1996. This letter describes USTA's position on universal service and describes a new universal service plan which provides that the universal service support provided implicitly through exchange carrier rates be replaced by a combination of rate rebalancing and explicit support sufficient to ensure that universal service is maintained with affordable rates for all customers.

An original and a copy of this letter are being filed in the Secretary's office on October 3, 1996. Please in include it in the public record of this proceeding.

Respectfully submitted,

Linda Kent

Linda Kent
Associate General Counsel

Attachment

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UNITED STATES
TELEPHONE
ASSOCIATION

October 3, 1996

TO: The Honorable Reed E. Hundt
The Honorable Susan Ness
The Honorable Rachelle B. Chong
The Honorable Kenneth McClure
The Honorable Julia Johnson
The Honorable Sharon L. Nelson
The Honorable Laska Schoenfelder
Ms. Martha S. Hogerty

RE: Universal Service

In its comments filed April 12, 1996 with the Federal State Joint Board, the United States Telephone Association (USTA) recommended that an explicit funding mechanism be created by the Joint Board to fund only the interstate portion of the costs of providing the defined universal service package above a benchmark level. States would develop separate mechanisms to fund the intrastate portion of the costs of providing universal service above their own benchmarks. USTA also recommended that the current Universal Service Fund and weighted Dial Equipment Minutes support mechanisms be continued, although only for rural telephone companies as defined by the Telecommunications Act of 1996, to ensure that high loop and switching costs for these companies continue to be funded in the interstate jurisdiction, thereby preventing a shift of current federal high cost support back to the states for recovery. In a series of ex parte meetings, USTA discussed this plan with the members of the Joint Board and/or their staffs.

As of August 8, 1996, USTA's filed plan is no longer viable. On that date, the Commission released its Order implementing the local competition provisions of the Act in CC Docket No. 96-98 (Interconnection Order). That Order eliminated the LECs' ability to support the local exchange network with usage-based access, toll and vertical service revenues. In particular, the FCC has mandated pricing requirements to the states that deprive the states of the ability to maintain current state price structures and that require that states immediately address universal service issues. As a result, the FCC, by regulatory fiat, has removed the support which traditionally has maintained universal service, thereby exacerbating the challenge before the states to preserve universal service. It has also impeded the LECs' ability to maintain the very network which will be the platform for the development of a competitive network.

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It is certainly no secret that decades of prior FCC and Joint Board decisions deliberately and systematically allocated costs to the interstate jurisdiction to keep local rates low. Cross subsidies, in fact, flow not only between the federal and state jurisdictions, but also among various regulated LEC services. In general, business and urban users support residential and rural users. Long distance and value-added services support local telephony. These traditional methods of support have been relied upon to further universal service.

The Interconnection Order requires the incumbent LECs, which have built and operated the local network used to provide universal service, to wholesale both their services and parts of their network to competitors at prices which are substantially below cost.[1] This includes both interstate and intrastate services as well as network elements used to provide both interstate and intrastate services. Fair and efficient competition is beneficial and should result in lower prices and new services for subscribers. However, the Interconnection Order will not encourage fair and efficient competition. USTA now realizes the magnitude of the problems which implementation of the Interconnection Order will create and that these problems cannot be dealt with under the universal service plan USTA filed in April. USTA commissioned a study long before the passage of the 1996 Act to analyze the impact of competition on universal service. That study estimated the support from toll and access services to maintain reasonable local rates to be $20 billion on a nationwide basis.[2] The problem is now much worse because of the FCC's decision.

The sources of revenue which recover the costs of the network and the provision of universal service are local exchange service and support from toll, access and other services. The arbitrage between access and local interconnection and unbundled network elements, created by the Order, will quickly erode these revenues. They will no longer be available to support universal service. Competitors will continue to cream skim the highest revenue producing subscribers in the lowest cost geographic areas on an unbundled basis and resell services to the rest. As LECs lose customers, the LECs' costs per subscriber will rise but their revenue per remaining subscriber will decline. This effect will be magnified because many (if not most) of the customers LECs will "lose" will still be served by the LECs on a wholesale basis through unbundled network elements. The FCC-mandated prices for these elements is such that LECs will not receive sufficient revenues to cover the costs of serving those customers. Thus, previously "subsidizing" customers will become "subsidized" customers.

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[1]The Interconnection Order also restricts the states' ability to oversee the development of competition within their borders by mandating the terms and conditions under which interconnection is permitted.

[2]Calvin S. Monson and Jeffrey H. Rohlfs, "The $20 Billion Impact of Local Competition in Telecommunications", July 16, 1993.

The Interconnection Order also allows interconnecting competitors to evade exchange access charges through the purchase of unbundled network elements. The Order completely eliminates the Carrier Common Line charge and the portion of the Residual Interconnection Charge currently permitted by July 1997. The loss of these revenues clearly threatens the continued provision of universal service. The Interconnection Order also defines vertical services as part of the unbundled switching element, effectively eliminating that particular means of support for universal service.

The pricing methodology mandated by the Order not only excludes historical costs and a full measure of joint and common costs, it also assumes that costs should be measured based on a hypothetical network. The pricing system allows competitors the benefit of ignoring the actual costs of operating the existing network which has assured universally available services at reasonable rates. The pricing system also permits competitors the benefit of receiving prices that reflect not only the full economies and efficiencies that an incumbent LEC has achieved, but the efficiencies of a hypothetical state of the art network. By shielding competitors from bearing the true costs of a network, the Commission will permit entry by competitors whose own inefficiencies will be subsidized by below-cost pricing.

As a result of the Interconnection Order, LECs will be required to provide services that are currently subsidized at rates that do not cover their costs. Contributions from prices charged from other services which have been used to cover the costs of local services will no longer be available because of the arbitrage created by the Commission's Order. It is imperative that the Joint Board decision on universal service reflect this impact. USTA has analyzed the impact of the Order on universal service and has designed a revised plan that, in particular, attempts to assist the states in dealing with some of the adverse affects of the Interconnection Order.

USTA's plan (attached hereto) would provide support for the actual, embedded costs of providing a defined universal service package of services less the revenues generated by that package. A national funding index would be established to identify the universal service costs funded at the federal and state levels. Costs above the index would be recovered via the national fund created by the Joint Board. Any remaining costs above current rates would be the responsibility of the states. USTA estimates that the federal funding requirement would be approximately $15 billion and the state funding requirement would be approximately $6 billion.

Telecommunications carriers would contribute to universal service in a competitively-neutral manner. Funding would be recovered by each telecommunications carrier through a surcharge on the customer bill based on that customer's purchases. The fund should replace the current explicit mechanisms such as USF and LTS. The subsidies implicit in interstate prices, including CCL, weighted DEM and EUCL prices, and the subsidies implicit in intrastate prices, including vertical service prices, business line prices, intraLATA toll prices and switched access prices, should also be replaced on a dollar for dollar basis with price rebalancing or through the explicit fund. In fact, price rebalancing, including permitting EUCL prices to transition to the lower of the service area's loop cost or the nationwide average interstate loop cost, could be used to reduce the size of the fund in a competitively-neutral manner.

This plan addresses the problems created by the Interconnection Order by allowing the universal service support provided implicitly through exchange carrier rates to be replaced by a combination of rate rebalancing and explicit support sufficient to ensure that universal service is maintained with affordable rates for all customers. Also, this plan will accommodate any changes ultimately made in the Interconnection Order, should the FCC on its own motion or as a result of Court action sought by USTA, rectify the Order's pricing infirmities as outlined above. USTA strongly urges the Joint Board to adopt this proposal.

Respectfully submitted,

Roy Neel
President and CEO

Attachment

cc: Federal State Joint Board Staff

October 3, 1996

USTA
UNIVERSAL SERVICE

GENERAL PRINCIPLES

1. **Definition**

- Voice grade access to public switched network to enable a customer to place and receive calls (loop, switch and transport)
- Touchtone
- Single party residence and business service (includes business and residential lines)
- Access to emergency services 911/E911
- Access to operator services
- Standard white page directory listing
- Access to basic local directory assistance

2. **Cost Standard**

- Universal service support should be based upon actual, embedded costs. Types of costs include loop, switch and transport costs (transport costs to be recovered through universal service would not include access or toll transport).
- Costs associated with under-depreciated, embedded plant should be identified and recovered separately.

- TSLRIC is inappropriate for determining universal service support because it fails to provide sufficient support, does not identify all costs associated with providing universal service, and reduces incentives for future capital deployment.

3. **Affordability**

- The cost of universal service from a customer's perspective must consider the total charge for universal service. The total charge includes both interstate and intrastate prices incurred by the customer when the customer purchases local service.

- The total charge should be treated as a household expenditure expressed as a percentage of median household income over a specified geographic area to reflect what customers reasonably can expect to pay for service.

4. **National Funding Index**

- To determine the amount of funding to be raised at the federal and state levels, a national funding index should be set at 1 percent of county median household income.

5. **Support**

- Support is the difference between universal service costs for the universal service cost area and the universal service revenues generated by that area (Support = Universal Service Costs - Universal Service Revenues).

- Transitional support should be available when the proposed universal service plan generates less support than is currently received from USF, Weighted DEM and Long Term Support.

6. **Funding**

- All telecommunications carriers that provide interstate services shall contribute to the fund (this includes, at a minimum, LECs, IXCs, CAPs, CMRS providers, cable TV providers of telephony).

- The funding base should include interstate and intrastate retail revenues.

- The federal funding surcharge = Federal support ÷ Federal funding base.

- All telecommunications carriers contribute an amount equal to the federal funding surcharge times their share of the revenues contained in the funding base.

- The funding requirement could be reduced by increasing interstate and intrastate prices in areas that require support when the total universal service charge is less than the national funding index.

- States should be provided with guidelines to make up the difference, if any, between revenue from local rates and revenue at the level of the national funding index through some combination of local rate increase or state universal service fund.

7. **Fund Recovery Mechanism**

   - The federal portion of the fund should be recovered by every telecommunications carrier through a surcharge on the customer bill based on the amount of that customer's purchases.

8. **Price Rebalancing**

   - Interstate and intrastate prices will be reduced to the extent possible to remove implicit support.

   - To reduce the size of the fund EUCL prices should be capped at the lower of the service area's loop cost or the nationwide average interstate loop cost.

9. **Implementation**

   - Existing mechanisms, such as CCL, USF and weighted DEM may be replaced by support from either the new universal service fund or price rebalancing (See Item 8).

- Interstate and intrastate price reductions will be made on a revenue neutral basis to offset explicit support received from the new universal service funding mechanism.

10. Eligible Carriers

- Eligible carriers that use their own facilities to provide universal service qualify to receive support based upon individual company costs. Eligible carriers would not receive funding for customers served through resale of another carrier's local exchange service.

- Carriers must meet any requirements with respect to pricing, terms, conditions, quality standards, etc., established by state commissions; these requirements should be the same for any carrier seeking to receive support.

11. Efficient Long Distance Prices

- Interexchange carriers must match access charge reductions resulting from the removal of implicit support by reducing long distance prices on a dollar-for-dollar basis.

October 3, 1996

USTA UNIVERSAL SERVICE PROPOSAL

Universal Service Definition

1. Voice grade access to the public switched network with ability to place and receive calls (includes loop, switching and local transport).

2. Touch Tone.

3. Single party service and business service (includes business and residential lines).

4. Access to emergency services (911/E911).

5. Access to operator services.

6. White Page Directory Listing.

7. Access to basic local directory assistance

Types of Costs to be Recovered Through Universal Service

1. Universal service support should be based upon actual, embedded costs that are regulated and unseparated.

2. Types of costs to be recovered through universal service include 100 percent of loop costs, 100 percent of transport costs assigned to local (does not include access or toll transport) and switching costs, to include 100 percent of line port costs and scaled to switch size as follow:

Switch Size	Costs Recovered Through universal Service
1 - 500 lines	90 percent of total switching costs
501 - 5,000 lines	80 percent of total switching costs
Over 5,000 lines	70 percent of total switching costs

3. A proxy model which closes to actuals must be used as a surrogate for actual costs when the universal service area is smaller than a wire center and may be used at the wire center level.

Universal Service Cost Area

1. LECs should have the flexibility to designate either a study area, a wire center or a smaller area as the geographic area over which universal service costs will be measured.

2. The universal service cost area may be smaller than the eligible carrier's serving area.

National Funding Index

1. The National Funding Index should be expressed as a percentage of median household income over a specific geographic area to reflect what customers reasonably can expect to pay for service.

2. The National Funding Index should be established as follows:

   Residence Index: 1 percent of county median household income

   Business Index: 1.5 times the residence amount

3. A floor set a standard deviation below the index and a ceiling set a standard deviation above the index should be specified to better reflect the current nationwide average rate, to better identify the need for Lifeline Assistance and to smooth the volatility of using county median income.

Universal Service Support

1. Support is based on the difference between universal service costs for the universal service cost area and the universal service revenues generated by that area.

2. Support is provided to eligible carriers that use their own facilities to provide universal service based on individual carrier costs.

3. The cost per line and the support per line is calculated annually (unless a proxy is used). When multiple eligible carriers are receiving support in a universal service area, the cost per line should be frozen and the support per line would be capped at the incumbent carrier's level. The cost per line should be recalculated if the definition of universal service changes.

4. Support would not be provided for customers served on a resale basis.

5. Transitional support should be available when the proposed universal service plan generates less support than is currently received from USF, Weighted DEM and Long Term Support in addition to support from the proposed plan. Transitional support would be phased down over a eight year period as follows:

   Year 1 = new plan plus 100 percent of transitional support amount

   Year 2 = new plan plus 95 percent of transitional support amount

   Year 3 = new plan plus 90 percent of transitional support amount

   Year 4 = new plan plus 85 percent of transitional support amount

   Year 5 = new plan plus 80 percent of transitional support amount

   Year 6 = new plan plus 75 percent of transitional support amount

   Year 7 = new plan plus 50 percent of transitional support amount

   Year 8 = new plan plus 25 percent of transitional support amount

   Year 9 = new plan

6. States should be provided with guidelines to make up the difference, if any, between revenue from local rates and revenue at the level of the national funding index through some combination of local rate increase or state universal service fund.

Universal Service Funding

1. All telecommunications carriers that provide interstate services shall contribute to the fund. This includes, at a minimum, LECs, IXCs, CAPs, CMRS providers, cable TV providers of telephony.

2. When universal service costs exceed universal service revenues, federal support will be the lower of:

   The difference between universal service cost per line and the National Funding Index.

   The difference between universal service cost per line and universal service revenue per line.

3. Funding would be based on interstate and intrastate retail revenues.

4. Federal funding surcharge to be recovered from end users = Federal support ÷ Federal funding base.

5. All telecommunications carriers will contribute an amount equal to the federal funding surcharge time their share of the revenues contained in the funding base.

Universal Service Funding Recovery Mechanism

1. Funding should be recovered by every telecommunication carrier through a surcharge on the customer bill based on that customer's purchases.

Implementation

1. Costs and revenues will continue to be jurisdictionalized and separations allocators will not change.

2. Existing explicit mechanisms such as USF and LTS will be replaced by support from the new federal funding mechanism.

3. Interstate and intrastate prices will be reduced to the extent possible to remove implicit support. Interstate and intrastate price reductions will be made on a revenue neutral basis to offset explicit support received from the new federal funding mechanism.

   Examples of price reductions:

      Interstate: switched access prices (CCL), switching prices (Weighted DEM), EUCL prices (broad geographic averaging), etc.

Intrastate: vertical service prices, business line prices, intraLATA toll prices, switched access prices, etc.

4. Federal universal service support should be jurisdictionalized interstate and intrastate to determine which prices to lower.

UNITED STATES TELEPHONE ASSOCIATION
UNIVERSAL SERVICE SUPPORT ESTIMATE

1. Universal Service Cost		$ 53,500 (M)
2. Universal Service Cost in High Cost Areas		42,200 (M)
3. Universal Service Revenues in High Cost Areas		20,700 (M)
4. Universal Service Funding	(Line 2 less Line 3)	21,500 (M)
5. Federal Funding Requirement		15,200 (M)
6. State Funding Requirement	(Line 4 less Line 5)	6,300 (M)

NOTE: The funding requirements for Federal and State are based on a National Funding Index of 1 percent of county median income. The amount could change depending upon the floor and ceiling imposed on the Index.